

G-007/M-92-518 ORDER ESTABLISHING DEMAND SIDE MANAGEMENT
FINANCIAL INCENTIVE PILOT PROJECT, CLARIFYING STATUS OF CIP
TRACKER ACCOUNT, AND REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm
Tom Burton
Cynthia A. Kitlinski
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Chair
Commissioner
Commissioner
Commissioner

In the Matter of the Proposal of
Northern Minnesota Utilities for
a Demand-Side Management
Incentive Mechanism

ISSUE DATE: August 5, 1993

DOCKET NO. G-007/M-92-518

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MANAGEMENT FINANCIAL INCENTIVE
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PROCEDURAL HISTORY

I. Proceedings to Date

On October 18, 1991 the Commission issued an Order requiring all regulated gas utilities, except Midwest Gas, to file proposals for financial incentives to promote demand side management.¹ Midwest Gas was exempted because that company was already implementing a financial incentive program as a pilot project. On June 8, 1992 Northern Minnesota Utilities (NMU or the Company) filed its demand side management incentive proposal.

The Department of Public Service (the Department) and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) filed comments on August 31, 1992. Both agencies recommended approving the proposal with modifications.

The Company's filing revealed ambiguity about whether the Commission had authorized a tracker account for recording the Company's Conservation Improvement Plan expenses, and if so, whether the Commission had authorized a carrying charge.

The Company's financial incentive proposal and the tracker account and carrying charge issues came before the Commission on July 8, 1993.

¹ In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand Side Resource Options for Minnesota Gas Utilities, Docket No. G-999/CI-91-188, ORDER REQUIRING GAS UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS (October 18, 1991).

FINDINGS AND CONCLUSIONS

II. The Company's Proposal; the Parties' Comments

The Company's financial incentive proposal has three main parts: (1) full recovery of all margins lost due to energy savings achieved through successful Conservation Improvement Plan (CIP) projects; (2) a cash bonus equal to 25% of lost margins to reward successful demand-side management efforts; (3) a monthly conservation surcharge on customer bills to recover current and past CIP expenses, lost margins, and bonuses.

The Department and the RUD-OAG recommended linking recovery of lost margins and cash bonuses to the Company's achievement of its CIP goals and opposed the proposed monthly surcharge.

III. Commission Action on the Financial Incentive Proposal

A. The Statutory Standard

The Public Utilities Act authorizes the Commission to require utilities to develop financial incentives for demand side management and requires the Commission to consider the following factors in evaluating those plans:

- (1) whether the plan is likely to increase utility investment in cost-effective energy conservation;
- (2) whether the plan is compatible with the interest of utility ratepayers and other interested parties;
- (3) whether the plan links the incentive to the utility's performance in achieving cost-effective conservation; and
- (4) whether the plan is in conflict with other provisions of the Public Utilities Act.

Minn. Stat. § 216B.16, subd. 6c (1992).

B. Lost Margin Recovery

The Department and the RUD-OAG urged the Commission to tie NMU's recovery of lost margins to achievement of its CIP goals. These agencies are rightly concerned with performance; two of the four factors the statute requires the Commission to consider in acting on incentive proposals deal with performance. The Commission believes, however, that at least for the present limiting recovery to margins actually lost due to conservation adequately ties recovery to performance. Only when energy has been saved will the Company recover lost margins.

Furthermore, allowing recovery of lost margins is necessary to put demand side resources on an equal footing with supply side resources. Lost margin recovery removes the penalty (profit reduction) that would otherwise accompany successful demand side management efforts.

C. Incentive Bonus

The Department and the RUD-OAG recommended modifying the Company's bonus proposal to tie bonus recovery more closely to attainment of CIP goals. The Department recommended a bonus of 10% of lost margins for exceeding goals by up to 10% and a bonus of 25% of lost margins for exceeding goals by more than 10%. The RUD-OAG recommended a plan similar to that approved for Northern States Power: a bonus of 10% of lost margins for meeting 50% to 100% of CIP goals, a bonus of 25% of lost margins for exceeding CIP goals, and no further bonuses once the Company achieved 120% of CIP goals.

The Commission agrees that any bonus recovery should be linked very closely to performance. The Company's plan does this by providing a constant 25% bonus for successful performance from the first unit of energy saved. The Department and the RUD-OAG plans refine the performance link by granting specified bonus amounts for meeting specified percentages of the Company's CIP goals.

The Company's and the agencies' plans have their own strengths and weaknesses. The Company's plan provides continuous positive reinforcement, generally an effective motivator, and is easy to administer. At the same time, it does not target achievement of CIP goals, as opposed to conservation in general, for reinforcement. The agencies' plans have the advantage of directly reinforcing the attainment of CIP goals. They have the disadvantage, however, of failing to reward conservation below certain points and of creating thresholds at which bonuses increase without any clear objective justification.

The Commission will adopt a bonus mechanism that attempts to incorporate the strengths, and minimize the weaknesses, of both types of plans. The Company's proposed bonus amount of 25% of lost margins will be adopted as a baseline figure and pro-rated to reflect Company attainment of its CIP goals. For example, attainment of 100% of CIP goals will yield a 25% bonus; 50% attainment a 12.5% bonus; 200% attainment a 50% bonus. The bonus will be capped at 200% attainment, on the assumption that attainment beyond that point more likely reflects unrealistically low goals than outstanding achievement.

D. Monthly Conservation Surcharge

When the Company filed its request for a monthly surcharge on customer bills to recover past and future conservation costs, it was reasonably clear that such surcharges were not permitted

under Minnesota law. The Public Utilities Act established limited categories of expenses for which monthly rate adjustments were permissible -- federally regulated wholesale power delivered through interstate facilities, fuel costs, and taxes, fees, and permits. Minn. Stat. §§ 216B.12, subd. 7 and 216B.241, subd. 2b (1992). Apart from these explicit statutory exceptions, rates set by the Commission were to remain in effect until changed after full Commission review. Minn. Stat. § 216B.16, subd. 5 (1992).

During the last session the Legislature enacted legislation, effective August 1, 1993, authorizing the Commission to approve rate schedules providing for annual recovery of the costs of CIP projects. Act of April 26, 1993, ch. 49, 1993 Minn. Sess. Law Serv. (West). The Company's proposal was not designed in light of the new statute, which speaks of "rate schedules," not "surcharges." The Commission has not had the opportunity for comprehensive review of alternative means of implementing the new statute. This proceeding, which lacks any legal or policy analysis of the new statute by interested parties, would clearly be an inappropriate vehicle for addressing implementation issues of first impression. The Commission will therefore reject the Company's proposal for a monthly conservation surcharge, with the understanding that the Company is not necessarily precluded from later seeking to incorporate conservation costs into its rate schedule. Meanwhile, the Company's financial interests are adequately protected by its ability to record CIP expenditures in a deferred debit account, for eventual dollar-for-dollar recovery.

E. Refinements to Company's Financial Incentive Proposal

1. Weather Normalization; Appliance Rebate Surveys

The Department recommended requiring the Company to adjust all usage data relied upon in calculating lost margins to reflect normal weather conditions. The Commission agrees this will heighten the accuracy of lost margin calculations and will so order. The Department also recommended requiring the Company to do customer surveys to help estimate the percentages of energy-efficient appliances in use before and after cash rebate CIP projects. The Commission agrees that this could provide useful information and will so require.

2. Further Filings Required

The Commission required gas utilities to file financial incentive proposals to get first hand experience with financial incentives as tools for encouraging greater reliance on demand side resources and technologies. As the Commission explained in its Order:

. . . . By doing this, the Commission is not finding that financial incentives are in the public interest and should become a permanent part of gas utility ratemaking. It may turn out that financial incentives are useful primarily as devices to ease the transition from supply side management to a combination of supply side and demand side management. It may turn out that the role of financial incentives should be limited to encouraging utilities to find and implement the most cost effective conservation programs possible. For now, however, the Commission is convinced that the public interest requires serious consideration of financial incentive programs designed by individual utilities to increase their individual use of demand side management.

In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand Side Resource Options for Minnesota Gas Utilities, Docket No. G-999/CI-91-188, ORDER REQUIRING GAS UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS (October 18, 1991) at 2.

The Commission will therefore approve NMU's financial incentive plan as a two-year pilot project. At the end of the project, the Commission will evaluate its success and determine in what form, if any, it should continue.

To ensure meaningful data at the end of the two-year period, it is important to have a workable plan for evaluating the project's results. The Commission will require the Company to file a plan for evaluating the success of the pilot project within 45 days of the date of this Order. Similarly, to avoid as many future conflicts as possible, it is important to have a working understanding of how lost margins attributable to conservation will be measured. The Commission will therefore require the Company to file a proposal for measuring lost margins within the same 45 day period.

To allow interim monitoring of project performance and conservation expenses, the Commission will require annual reports giving the status of the CIP tracker account, lost margins and bonuses accrued to date, and interim evaluations of the pilot project. The Company will propose dates for these annual filings in the 45-day filing required above.

IV. Tracker Account, Carrying Charge, and Cost Recovery Issues

The Company's June 8 filing revealed some ambiguity as to whether the Company had been authorized to establish a deferred debit (tracker) account for CIP expenses and whether a carrying charge on amounts in the account had been approved. The Commission regrets the ambiguity and will clarify the status of the tracker account here.

The Company was authorized to establish a tracker account as part of its 1984 rate case. The Commission finds that the Company has had an authorized tracker account since the date of that Order and will recognize all CIP expenses properly recorded therein, subject to normal review for prudence and reasonableness.

The Commission has never explicitly approved a carrying charge for amounts in the tracker account, and in fact explicitly denied a Company request for a carrying charge in 1988.² Consistent with its treatment of other utilities, the Commission will, however, approve a carrying charge on amounts in the tracker account from the beginning of the 1992 CIP year. The carrying charge will be equal to the Company's currently authorized rate of return.

Finally, the Commission notes that the Company's filing, like some of its past CIP filings, suggests that CIP costs be recovered from the customer class that received services and that amounts be amortized over a two-year period. The Commission clarifies that cost recovery issues are generally addressed in general rate cases or other comprehensive rate proceedings and that the Company has received no authorization for any particular cost recovery procedure.

ORDER

1. Northern Minnesota Utilities' financial incentives proposal, as modified above, is approved as a two year pilot project.
2. During the course of this pilot project the Company shall file annual reports giving the status of the CIP tracker account, lost margins and bonuses accrued to date, and interim evaluations of the pilot project.
3. Within 45 days of the date of this Order, the Company shall file a plan for measuring lost margins attributable to conservation, a plan for evaluating the financial incentives pilot project, and proposed dates for the annual interim filings described above.
4. The Company shall adjust all usage data relied upon in calculating lost margins to reflect normal weather conditions.

² In the Matter of the Implementation of an Energy Conservation Improvement Program for Northern Minnesota Utilities, a Division of UtiliCorp United, Inc., Docket No. G-007/M-88-259, ORDER APPROVING CONSERVATION IMPROVEMENT PROGRAM AND REQUIRING ADDITIONAL FILINGS (September 29, 1988) at 6.

5. The Company shall conduct customer surveys to help estimate the percentages of energy-efficient appliances in use before and after cash rebate CIP projects.
6. The Commission clarifies that the Company has been authorized to maintain a deferred debit account to record CIP expenses (a CIP tracker account) since the final Order in its 1984 general rate case.
7. Effective as of the beginning of the 1992 CIP year, the Company is authorized to record in its CIP tracker account a carrying charge equal to its authorized rate of return.
8. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

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